

**THE WHITE HOUSE
WASHINGTON**

Executive Registry

85- 4246

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 10/24/85 Number: 317011CA Due By:

Subject: Economic Policy Council Meeting -- October 25, 1985

1:30 pm -- Roosevelt Room

| ALL CABINET MEMBERS | Action | FYI | | Action | FYI |
|---------------------|-------------------------------------|--------------------------|--------------------------|-------------------------------------|-------------------------------------|
| Vice President | <input checked="" type="checkbox"/> | <input type="checkbox"/> | CEA | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| State | <input checked="" type="checkbox"/> | <input type="checkbox"/> | CEQ | <input type="checkbox"/> | <input type="checkbox"/> |
| Treasury | <input checked="" type="checkbox"/> | <input type="checkbox"/> | OSTP | <input type="checkbox"/> | <input type="checkbox"/> |
| Defense | <input type="checkbox"/> | <input type="checkbox"/> | _____ | <input type="checkbox"/> | <input type="checkbox"/> |
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| Agriculture | <input checked="" type="checkbox"/> | <input type="checkbox"/> | | | |
| Commerce | <input checked="" type="checkbox"/> | <input type="checkbox"/> | McFarlane | <input checked="" type="checkbox"/> | <input type="checkbox"/> |
| Labor | <input checked="" type="checkbox"/> | <input type="checkbox"/> | Svahn | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
| HHS | <input type="checkbox"/> | <input type="checkbox"/> | Chew (For WH Staffing) | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> |
| HUD | <input type="checkbox"/> | <input type="checkbox"/> | HICKS | <input type="checkbox"/> | <input type="checkbox"/> |
| Transportation | <input checked="" type="checkbox"/> | <input type="checkbox"/> | _____ | <input type="checkbox"/> | <input type="checkbox"/> |
| Energy | <input checked="" type="checkbox"/> | <input type="checkbox"/> | _____ | <input type="checkbox"/> | <input type="checkbox"/> |
| Chief of Staff | <input checked="" type="checkbox"/> | <input type="checkbox"/> | _____ | <input type="checkbox"/> | <input type="checkbox"/> |
| Education | <input type="checkbox"/> | <input type="checkbox"/> | _____ | <input type="checkbox"/> | <input type="checkbox"/> |
| OMB | <input checked="" type="checkbox"/> | <input type="checkbox"/> | Executive Secretary for: | | |
| CIA | <input checked="" type="checkbox"/> | <input type="checkbox"/> | DPC | <input type="checkbox"/> | <input checked="" type="checkbox"/> |
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| SBA | <input type="checkbox"/> | <input type="checkbox"/> | _____ | <input type="checkbox"/> | <input type="checkbox"/> |

REMARKS:

The Economic Policy Council will meet on Friday, October 25, 1985 at 1:30 pm in the Roosevelt Room.

The agenda and background papers are attached.

RETURN TO:

☐ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☐ Rick Davis
☐ Ed Stucky

Associate Director

THE WHITE HOUSE
WASHINGTON

October 23, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER *EM*
SUBJECT: Agenda and Paper for the October 25 Meeting

The agenda and paper for the October 25 meeting of the Economic Policy Council are attached. The meeting is scheduled for 1:30 p.m. in the Roosevelt Room.

The single agenda item will be parallel imports, or so-called gray market goods. The Working Group on Intellectual Property has devoted a great deal of effort to studying this issue, identifying the benefits and costs of parallel imports, and developing options for possible Administration action. A paper reflecting the Working Group's efforts is attached.

Attachment

**THE WHITE HOUSE
WASHINGTON**

ECONOMIC POLICY COUNCIL

October 25, 1985

1:30 p.m.

Roosevelt Room

AGENDA

1. Parallel Imports

THE WHITE HOUSE
WASHINGTON

October 23, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE WORKING GROUP ON INTELLECTUAL PROPERTY
SUBJECT: Parallel Importation of Trademarked Goods

Issue

Should the Administration alter its policy regarding parallel imports?

Parallel imports or so-called gray market goods are products manufactured overseas bearing genuine trademarks which are bought from foreign retailers or wholesalers and imported into the U.S. without the permission of the individual or corporation who owns the rights to the trademark in the U.S. market. Current U.S. policy permits these goods to enter the U.S. when the foreign and American owners of the trademark are "related."

In January of 1985, the President, in rejecting a recommendation of the International Trade Commission (ITC) in a trade case involving Duracell batteries, stated that the current U.S. policy regarding parallel imports should not be altered, pending a review of the issue by the Administration "with a view toward formulating a cohesive policy."

Background

U.S. trademark law protects the reputation or goodwill established by trademark owners and protects the public from mistake, deception, and confusion with regard to a product's source. This is achieved through a Federal registration system which gives persons or corporations owning trademarks in the U.S. the right to have the Customs Service exclude at the border imports which bear marks that would "infringe" on a Federally-registered trademark, i.e. which copies or simulates a trademark registered in the United States.

Since 1922, U.S. law also has prohibited the importation of products manufactured overseas bearing genuine trademarks which are registered in the U.S. absent the express consent of the U.S. trademark owner at the time the product enters the United States. Customs regulations, however, have traditionally recognized a "related-party" exception to this general statutory prohibition.

This exception permits products manufactured overseas to enter the U.S. without the permission of the American trademark owner in cases where the foreign manufacturer is "related" to the American trademark owner, e.g. is a parent, subsidiary, or licensee. Typically these products are imported into the U.S. by unrelated third parties.

The volume and scope of these imports has increased in recent years due, in part, to the high value of the dollar, making the Custom's "related party" exception a contentious issue with U.S. trademark owners, who claim that the ability of third parties to import trademarked goods into the U.S. without their permission infringes upon their intellectual property rights in the U.S.

Competing Goals

The decision whether to maintain or reform the Custom's "related party" exception involves weighing the cumulative benefits of two competing goals of the Administration: (1) promoting free trade and competition and reducing government interference in the market and (2) protecting intellectual property rights of U.S.-registered trademark owners.

Parallel importers reduce the effects of price discrimination on the part of multinational firms by engaging in arbitrage, i.e. transferring goods from low-price markets to high-price markets -- giving American consumers greater choices at lower prices. Parallel importers also, however, benefit from a "free ride" on the marketing and promotional efforts of owners of trademarks in the U.S. and their authorized distributors. The extent to which either of these factors is at work differs among industries and products and is difficult to quantify.

(1) Price Discrimination

To some extent, parallel imports are caused by the efforts of some multinational firms to segment world markets through price discrimination, i.e. charging different prices for their product in different parts of the world.

- o Because parallel importers frequently make name brand goods available to American consumers at prices lower than those offered by dealers authorized by the U.S. trademark owner, American consumer welfare is improved.
- o Were the U.S. to prohibit all parallel imports, the Federal Government would become an enforcing party to private sector decisions to segment world markets and practice price discrimination.

(2) Free-Riding

To some extent, parallel imports are caused by the ability of third parties to benefit from a "free-ride" on the marketing and service efforts of U.S. trademark owners and their authorized dealers.

- o The availability of parallel imports not subject to the quality control of the U.S. trademark owner may dilute the value of the trademark to its U.S. owner and authorized distributors.
- o This provides parallel importers with an advantage over U.S. trademark owners and may over time reduce the investment in developing and marketing trademarked goods in the U.S.
- o In addition, while parallel importers may offer warranties equal to those offered by authorized U.S. dealers, consumers may erroneously believe that the warranty and servicing provision on parallel imports can be redeemed at dealers authorized by the U.S. trademark owner.

The Working Group on Intellectual Property sought reliable information about the magnitude of parallel imports and their effects on the property rights of U.S. trademark owners and the economic welfare of consumers, and the extent to which parallel import activity can be explained by the high value of the dollar, real cost differentials, or outright price discrimination by multinational firms between geographic markets. A survey published in the Federal Register under the direction of the Working Group failed to generate sufficient useful information on which to base a policy recommendation.

Existing Remedies

Because parallel imports enter the U.S. through third party distribution channels unauthorized by the U.S. trademark owner, and not under control of the foreign manufacturer, it is impossible for U.S. trademark owners to prevent such activity through contractual arrangements with foreign manufacturers. Therefore, U.S. trademark owners have typically sought relief in Federal court claiming under traditional trademark law that parallel imports infringe upon U.S. trademarks.

However, because the validity of the Custom's regulation permitting parallel imports to enter the U.S. when trademark owners are related has been specifically upheld by Federal courts, and because parallel imports bear genuine -- rather than counterfeit or confusingly similar -- trademarks, Federal courts have generally not provided the remedy desired by U.S. trademark owners.

Supporters of current Federal policy regarding parallel imports suggest that States can and should enact legislation which would benefit trademark owners and consumers by requiring explicit labeling of parallel imports, including warranty information. New York State already has enacted such a statute. It should be noted, however, that labeling may impose substantial costs on parallel importers and result in varying degrees of consumer information regarding the distinction between parallel imports and authorized goods.

Congressional Views

Congress is divided on the issue. Republican members who have supported the status quo include Senators Chafee, Dole, Roth, and Rudman. Senators Abdnor, D'Amato, Hatch, and Laxalt have supported repeal or reform of that policy. In addition, the Senate Appropriations Committee recently issued a report noting the Administration's review of the parallel import issue and urging the Administration to make available to the Committee a report of its findings by December 31, 1985.

Policy Options

No single policy option is without drawbacks. In the absence of data to quantify the size of the so-called gray market in parallel imports or its impact domestically, the Working Group could not reach a consensus on a preferred policy.

Option 1: Maintain the existing Custom's enforcement policy.

This option is the status quo, continuing to permit parallel imports. U.S. trademark owners could seek remedies through Federal administrative and judicial or State legislative channels.

This option also is consistent with past recommendations of the OECD and United Nations which have encouraged member nations to eliminate restrictions on parallel imports where used to maintain artificially high prices or are otherwise anticompetitive.

Advantages

- o Benefits consumers through the discounting of name brand goods.
- o Encourages trademark owners to adjust international pricing to reflect currency exchange developments or real cost differences among markets or countries.

Disadvantages

- o Harms U.S. trademark-owners by permitting parallel importers to "free-ride" on marketing and service investments and demand established by them, and may diminish the goodwill and prestige value of U.S. trademarks.
- o Some consumers erroneously may believe that the warranty and servicing provisions on certain parallel imports are the same as those offered on goods sold through channels authorized by the U.S.-trademark owner.

Option 2: Establish a new Custom's policy requiring the trademark on parallel imports to be "demarked," i.e. removed or obscured prior to importation to the U.S., but permitting importers to affix their own "mark" to the product.

In theory, demarking would prevent free riding by removing trademarks from view, and price discrimination by permitting demarked imports to enter the U.S. and compete with trademarked goods.

Advantages

- o Benefits consumers by drawing a distinction between goods imported by the U.S. trademark owners and goods imported by the parallel importer, permitting importers and U.S. manufacturers to distinguish pricing, warranty, and service protections.
- o Protects the domestic goodwill and reputation established by U.S. trademark owners by eliminating "free riding" by parallel importers.

Disadvantages

- o May confuse consumers about the quality of demarked imports even where no quality difference in fact exists, potentially increasing costs to parallel importers.
- o Difficulties in defining "demarking" may make this policy prohibitively expensive to implement and monitor or impractical in cases where removal of the mark would damage the good, e.g. watches.

Option 3: Maintain the existing Custom's enforcement policy, while mandating Federal labeling requirements -- either on the good or at the place of purchase -- on parallel imports.

This option would require either new Federal labeling regulations or legislation.

Advantages

- o Enables consumers to make informed choices between parallel imports and authorized goods.
- o Protects the good will and reputation established by U.S. trademark owners, by eliminating consumer confusion regarding warranties and servicing on parallel imports.

Disadvantages

- o May be ineffective in putting consumers on notice of warranty and servicing distinctions between parallel imports and products distributed by the U.S. trademark owner.
- o Would increase costs to parallel importers and enforcement costs accruing to the Federal Government, potentially negating the current price benefits to consumers of parallel imports without solving the "free rider" problem.

Option 4: Promulgate a notice in the Federal Register soliciting public comment on the merits of Federal regulations requiring demarking or labeling of parallel imports.

This option does not commit the Administration to either demarking or labeling regulations.

Advantages

- o Gathers information regarding the costs and benefits of demarking and labeling.
- o On the other hand, if information shows demarking or labeling to be overly costly, impractical, or ineffective, the Administration could forego adopting such a policy.

Disadvantages

- o May be criticized as delaying resolution of the parallel import controversy.
- o May yield ambiguous information of little or no use in guiding future policy.

Option 5: Establish a new Custom's policy prohibiting all parallel imports without the express consent of the U.S. trademark-owner at the time of importation.

This option would replace the current case-by-case administrative and judicial remedies available to U.S. trademark-owners with a uniform Federal enforcement system.

Advantages

- o Protects consumers from deception or confusion regarding warranties and servicing on parallel imports and encourages manufacturers to differentiate their market development internationally.
- o Protects the intellectual property rights of U.S.-registered trademark owners.

Disadvantages

- o Harms American discount-retailers and consumers by encouraging geographic price discrimination even where quality, warranty, and service differences between authorized goods and nonauthorized imports are not significant.
- o Requires greater Federal interference in the marketplace.